

PART TWO

Working with other UK Regulators

The FSA's effectiveness in working with other UK regulators depends on communicating, collaborating and liaising regularly; information and expertise sharing; and reducing administrative burdens on jointly regulated firms.

This section of the report shows:

- **relationships and sharing regulatory techniques and expertise with other regulators**

The FSA has good and improving working arrangements with the Office of Fair Trading (OFT), The Pensions Regulator and the Financial Reporting Council, as well as with the Bank of England and HM Treasury in their arrangements for financial stability. The FSA and OFT have recently concluded parallel projects on the sale of Payment Protection Insurance by financial institutions, the outcome of which showed effective joint working (paragraphs 2.1 to 2.32).

- **future priorities for joint working with other regulators**

The main priority lies in the FSA's joint working with the OFT. The effective coordination they have demonstrated shows how the FSA can draw on the OFT's competition expertise in situations where financial markets may not deliver a fair deal for consumers (paragraphs 2.17–2.19). The FSA should also continue to coordinate with The Pensions Regulator to ensure a clear understanding of their respective responsibilities for protecting the interests of pension scheme members and for improving their financial capability (paragraphs 2.20 to 2.24).

The Office of Fair Trading (OFT)

2.1 The FSA and the OFT have different but complementary powers and statutory objectives. Their interests coincide in a wide range of areas, from ensuring that markets work well, to informing, empowering and

protecting consumers. Their roles sometimes overlap: for example, around 22,000 firms²³ are regulated by both the FSA and the OFT.

2.2 The FSA and OFT published a joint Action Plan in April 2006. The Plan marked a step change in the way the organisations worked together.²⁴ It identified areas where they can work more closely together e.g. communication with firms and consumers, and set out steps to reduce burdens on jointly regulated firms. The Action Plan is summarised at Appendix 2a).

2.3 The FSA and the OFT are exploring further opportunities for better joint working including:

- FSA involving the OFT in two key strategic areas: the review of the retail distribution system²⁵ and the post-implementation review of depolarisation²⁶;
- greater collaboration in respect of the Unfair Commercial Practices Directive and money laundering regulations; and
- a programme of short- and long-term secondments so that staff develop a practical understanding of the respective roles and responsibilities of each organisation.

Competition

2.4 Under the Competition Act 1998, the OFT has responsibility for enforcement of competition law in the UK. Some regulators, such as Ofcom and Ofgem, can exercise powers under the Competition Act, but the FSA cannot. Under Financial Services and Markets Act 2000, the FSA must have regard to competition²⁷, but this is not a primary objective. It therefore falls to the OFT to ensure that competition law is effectively applied in the UK financial services sector.

2.5 In addition to the Competition Act, the OFT has specific powers relating to financial services:

- Under Section 160(1) of the FSMA, the OFT has a duty to keep the regulating provisions and practices of the FSA under review.²⁸ Where the OFT considers that regulations may have a significant adverse effect on competition, it may make a report possibly leading to further action by HM Treasury.²⁹ The OFT has not used this power, and considers that this may have only limited relevance for regulations that derive from EU Directives (given the UK locus of the Act).
- The OFT receives copies of proposals on rule changes from the FSA, and can comment where appropriate, though it has not responded as a matter of routine.

2.6 In late 2003, the OFT launched a Financial Services and Markets Act Competition Review.³⁰ The objective of the review was to sift through markets affected by the Act to identify those areas that might raise competition concerns. The review did not find any indications that the Act had a significant adverse impact on competition in financial services markets. The review identified seven high level markets which exhibited either high levels of concentration or barriers to entry.³¹ The OFT decided not to carry out further work into these seven markets because some had been recently examined by other bodies, such as the Competition Commission's report on banking for SMEs in 2000; in the area of clearing and settlement the EU had recently proposed legislation; and in other areas the OFT considered that there was insufficient evidence to embark on further work.

Consumer credit

2.7 The OFT operates the licensing system for consumer credit providers established by the Consumer Credit Act 1974. Some firms carrying on financial business with consumers are required to apply for authorisation to the FSA and apply separately for a consumer credit licence to the OFT. This is because some aspects of their business fall within the scope of FSMA, while others fall under the Consumer Credit Act. These businesses include banks, building societies, mortgage advisers and general insurance brokers.

2.8 The Hampton Report³² suggested that the Government should consider the transfer of responsibility for consumer credit regulation from the OFT to the FSA. Following consultation with stakeholders, the Government concluded that a better regulatory outcome would be achievable without changing regulatory responsibility in this area. In this context, the FSA and the OFT recognised that they should work more closely together to improve the way in which they dealt with their jointly regulated firms.

2.9 Under the FSA/OFT joint Action Plan they carried out feasibility studies of the ways in which the administrative burden on jointly regulated firms could be reduced, including:

- **whether the FSA's authorisation and the OFT's consumer credit licensing processes could be aligned:**³³ They found that the number of firms affected would be relatively small.³⁴ Given this they considered that the cost to the two bodies of aligning their processes outweighed the benefits to this population of firms. This position has been endorsed by their industry user group.³⁵ Both the FSA and OFT are already developing online application systems which will deliver benefits to firms. They plan to revisit this area once both new systems are in place, to evaluate the costs and benefits of developing the systems further.
- **whether they could reduce the administrative burden on jointly regulated firms by making either the FSA or OFT solely responsible for collecting standing data changes, or by setting up a common interface for firms:** They found that there was no clear benefit to jointly regulated firms to change the current arrangements and this position was endorsed by their industry user group. Both the FSA and OFT have projects underway to develop systems that will enable firms to submit standing data changes online which should make it easier for firms to do business with both regulators.
- **whether they could rationalise the invoicing and collection of fees, so that in any one year a firm would receive a single invoice for fees due to the FSA, the OFT, Financial Services Compensation Scheme and Financial Ombudsman Service:** The benefit would be a reduction in the number of invoices received by firms but they considered that the cost saving would be minimal, particularly because firms make payments to the OFT only when applying for a licence or on renewal of that licence (currently every five years). The study proposed that no changes should be made to the existing revenue collection processes and this position has been endorsed by their industry user group.

2.10 The FSA's Enforcement Division and the Credit Licensing Investigation section of the OFT liaise about cases and issues of common interest. In particular, designated contacts from the respective teams meet regularly to discuss cases and exchange information where appropriate. There has been an increase in liaison between the FSA and OFT about cases and issues of common interest. However, the nature of the information disclosure gateways (particularly on the FSA side) restricts but usually does not prevent disclosure between the two organisations.

Consumer protection

2.11 The FSA and the OFT share a common interest in consumer protection. One of the FSA's four statutory objectives includes protecting consumers of financial services, and the OFT's overall objective is to make markets work well for consumers.

2.12 Both the OFT and FSA have powers over unfair contract terms under the Unfair Terms in Consumer Contracts Regulations 1999 (UTCCRs). They agreed a revised Concordat in July 2006. This commits the FSA and OFT to take necessary and proportionate action where there is evidence of a potential breach of the UTCCRs causing consumer harm. It also means that firms, in normal circumstances, are given a reasonable opportunity to stop relying on unfair terms, removing or revising them as appropriate, before formal action is taken. It will ensure that there is no duplication of effort and that action is taken by the body best placed to lead on any given issue. Under the new Consumer Credit Act 2006 consumers can access the Financial Ombudsman Service (FOS) for consumer credit complaints concerning firms that are licensed by the OFT but not authorised by the FSA.

2.13 In April 2006, the OFT published its findings on default charges in the credit card market. In September 2006, the OFT and the FSA announced that, in view of its work on default charges in the credit card market, the OFT would take the lead on a further piece of work looking at default charges on banks' current accounts.³⁶

Sharing Information

2.14 The FSA is subject to statutory restrictions on disclosing confidential information it has received about third parties. The restrictions do not apply to any information that the FSA has originated itself, or where it has obtained the consent of the provider of the information. But where the restrictions do apply the FSA can only pass confidential information about firms through a gateway (a statutory exception to these restrictions). Different restrictions apply depending on how the FSA obtained the information in question.

2.15 Under the Financial Services and Markets Act 2000 and the 'Disclosure Regulations', only limited gateways exist to disclose information to the OFT.³⁷ In particular, regulation 9 of the Regulations restricts the FSA's disclosure of confidential information obtained under EU single market directives. The current operation of this gateway might restrict the OFT's competition functions and means that there is a large category of information that the FSA cannot disclose to the OFT. HM Treasury are now reviewing the Disclosure Regulations and may amend them.

2.16 The Consumer Credit Act 2006 may have a positive impact on information sharing because under the new Act the OFT will gain new "supervisory" functions that it does not currently have, which may provide a gateway and increased scope for the FSA to pass information to the OFT.

Sharing expertise

2.17 The OFT's competition powers give it responsibility for applying competition law over major sectors of the UK economy. It has developed expertise in looking at competition matters in non-FSA areas of financial services, in particular consumer credit, one of its five priority areas as described in the OFT's Annual Plan 2006-07. However, the financial services sector is complex, and specialist knowledge is often required. If the OFT undertakes work on financial services, it should draw on the FSA's expertise.

2.18 The FSA and the OFT have worked together successfully on the issue of Payment Protection Insurance (PPI), taking advantage of their different but complementary perspectives. The FSA is primarily concerned with how financial institutions conduct their business, while the OFT is more concerned with the operation of the market. Developing a relationship through which the FSA focuses on the behaviour of financial institutions and the OFT more on market outcomes provides a model for future successful joint working between the two organisations (**Figure 9 overleaf**). They can also use the comparative advantage that each body has in the penalties and remedies they can recommend to achieve an outcome that is beneficial to consumers. The FSA can speedily address consumer detriment for customers of a specific firm found not to be observing the FSA's principles and Rulebook by fining the firm or by imposing a public censure (as they have done following their PPI work³⁸). The OFT can consider whether remedies might be appropriate and make recommendations across all the firms in the relevant market if they undertake a market study that finds that the market is not working well for consumers. However, a market study (with a possible referral of the matter to the Competition Commission to undertake a formal market investigation) can take a lot longer to reach a conclusion than the penalties available to the FSA.

2.19 The FSA and the OFT intend to collaborate on, or should explore closer collaboration on:

- **Supervision:** The Consumer Credit Act 2006 extends the OFT's existing supervisory functions by introducing a change to the fitness test applied to applicants for consumer credit licences. In certain circumstances, the OFT may undertake an on site assessment of credit competence. The FSA may share its extensive knowledge and experience of supervision with the OFT.

9 Case study – Payment Protection Insurance

The FSA took responsibility for regulating the insurance market in January 2005. It decided to review the selling practices of payment protection insurance (PPI), which is widely available to consumers of credit products and protects the borrower's ability to keep up the payments on a loan in case of accident, sickness or unemployment. It carried out this project between May and October 2005, with supervision visits to 45 firms selling PPI and a mystery shopping exercise. It published its report in November 2005 and subsequently completed a second round of visits to a further 40 firms selling PPI.

In the course of analysing the results, it became apparent that as well as compliance problems with the sales process, there were problems arising from the operation of the market caused by the lack of effective competition at point of sale. The FSA considered that these issues were more appropriately dealt with by the OFT as a competition regulator. In addition, PPI is often sold alongside a credit agreement, which meant that the OFT as regulator of consumer credit had a regulatory interest in this area.

In September 2005 the Citizens Advice Bureau published a report on PPI with recommendations to both the FSA and the OFT. At the same time they submitted a super-complaint to the OFT on PPI. In response the OFT decided to conduct a market study on PPI which it launched in April 2006.

The results of the OFT's examination gave it grounds to suspect that there were features of the market which restrict competition to the detriment of consumers. Despite some evidence of a

degree of consumer satisfaction with aspects of the product, they considered that the evidence, as a whole, suggested consumers got a poor deal. The OFT decided to refer the matter to the Competition Commission in February 2007 to undertake a thorough investigation of the market and, if necessary, ensure that appropriate remedies are put in place.

In reaching this decision the OFT took account of the work which the FSA is doing to remedy the problems relating to selling standards, as well as the various industry initiatives which are underway in response to the FSA's work. However the OFT and FSA agreed that the FSA's action targeted at selling practices alone cannot remedy the lack of competition that the OFT identified in the PPI sector.

During this project the two organisations shared information, including data on firms which the OFT used to select a sample for their business survey, and providing the documentation that the FSA collected from firms during their mystery shopping work. The FSA provided the OFT with a high level market failure analysis identified from its work, which provided input to the OFT's consideration of the super-complaint and early work on its market study. And the FSA sat on the OFT's steering group, the first time that the OFT has had an external organisation represented on such a steering group. Overall, trade associations consider that, after an uncertain start when they appeared to be uncoordinated, the PPI project exhibited effective joint working between the FSA and the OFT.

Source: National Audit Office

- **More principles-based regulation:** With the FSA's move to a more principles-based approach to regulation, it recognises that there is a potential role for industry codes to clarify and support its principles. The OFT has developed a consumer codes regime through which it approves codes developed by a particular industry. The FSA and the OFT worked collaboratively on their formal responses to the Banking Codes Review, and should continue to do so.³⁹
- **Consumer protection:** The FSA, the OFT and the FOS all have a role in the protection of consumers of financial services, and can work together in raising awareness and clarifying their respective roles in relation to consumer financial services complaints and financial capability and education work where appropriate.

The Pensions Regulator (TPR)

2.20 The FSA does not regulate occupational pension schemes. But it does regulate firms which provide investments and investment services to occupational pension schemes. The FSA also has a statutory objective to promote public awareness and understanding of the financial system, which extends to all forms of pension provision.

2.21 The Pensions Regulator's objectives are to protect the benefits of members of work-based pensions, reduce the risk of situations arising where there may be a call on the Pension Protection Fund, and promote the good administration of work-based pensions. It is primarily concerned with ensuring the good administration of work-based schemes and protecting members' benefits. It was created by the Pensions Act 2004.

2.22 The FSA and the Pensions Regulator have sought to minimise the risk that investment firms face two regulators with conflicting approaches for pension business. In April 2005, they agreed a Memorandum of Understanding (MOU) which sets out the arrangements for co-operation, co-ordination and the exchange of information. There was an initial period where there was no statutory instrument in place to allow the exchange of information.⁴⁰ This did not cause any significant issues. The FSA and the Pensions Regulator share information effectively.

2.23 Issues on which the FSA and the Pensions Regulator currently coordinate and need to continue to collaborate closely include:

- **Secondary markets:** The UK pensions market has seen sponsoring employers increasingly keen to reduce the risk that they have to eliminate current or future pension deficits. The market has responded by developing schemes involving transfer of liabilities to a third party. The intention of pensions legislation is that employers can only fully discharge their responsibility to eliminate deficits by transferring to a regulated insurance company. But in some cases schemes have instead involved transferring liabilities to a nominal employer. Such an entity would take on a similar responsibility to an insurer but would lie outside the scope of FSA insurance regulation and may not have the regulatory capital to provide the appropriate guarantee. The FSA and TPR have worked together as the TPR has developed guidance for pension scheme trustees on handling such proposals.
- **Changes in the nature of pension schemes.** Pension schemes are increasingly shifting from a trust basis, where the assets of the scheme are held by trustees on behalf of the members, to a contract basis, where each individual member holds a contract with the scheme.⁴¹ While trust-based schemes are entirely the responsibility of TPR, regulatory responsibility for contract-based schemes is shared between TPR and the FSA. This is because FSA regulates the sales and marketing of personal pensions and related products, including pensions provided on a contract basis. It is also responsible for the authorisation of the insurance firms who provide these products and the investment firms that manage the investments.⁴²
- **Financial inducements:** There has been growing concern about the offer of inducements to pension scheme members. An inducement is where an employer offers scheme members a financial incentive to change the basis of their pension – for example, away from a pension based on final salary

at retirement. Although offering inducements is not illegal and advice on them is not regulated by the FSA and TPR⁴³, both bodies have collaborated on the issue, leading to the publication of guidance by TPR.⁴⁴

- **European coordination:** The FSA and TPR are both members of the Committee of European Insurance and Occupational Pensions Supervisors.
- **Risk and principles:** Both the FSA and TPR have collaborated in developing their sophisticated risk-based approaches and are exploring a focus on principles. The two organisations should continue to compare their risk models to ensure that they learn from each other.

2.24 In January 2007 the Minister of State for Pension Reform announced an independent review of the institutions involved in the regulation and protection of work-based pensions. The review will examine how the responsibilities of pensions institutions – such as TPR, Pension Protection Fund, and the Financial Services Authority – fit with the Government’s pension reform proposals. The review will be completed and report to Ministers in spring 2007.

Financial Reporting Council (FRC)

2.25 In some countries, a single body is responsible for securities regulation and enforcing audit and accounting standards, whereas in the UK these responsibilities are divided between the FSA and FRC and its operating bodies.

2.26 The FRC is the UK’s independent regulator for corporate reporting and governance. The FRC has a number of bodies that operate under its aegis, including the Accounting Standards Board (ASB), the Auditing Practices Board, the Board for Actuarial Standards, the Public Oversight Board and the Accountancy Investigation and Discipline Board. The FSA has a close interest in high quality accounting, audit and actuarial standards in the UK. In particular, the FSA as Listing Authority has a close concern with the integrity of financial information provided to the capital markets. The FSA therefore has an extensive network of relationships with the FRC and its operating bodies, with the most interactions being with the Financial Reporting Review Panel (FRRP). In addition, there are several meetings each year between the FSA, FRC, DTI and HM Treasury at which senior management are present, and one of the FSA’s Managing Directors is a member of the FRC’s Council.

2.27 Formal information flows are limited by legal constraints on the FSA's powers to pass information to the FRC. The FSA is allowed to disclose information for the purpose of enabling it to carry out its own functions, but its powers to disclose information to assist other organisations have been limited in the past by EU directives. As a result, the FRC asked HM Treasury to look at extending legal gateways for the passage of information, particularly to cover recent extensions to the FRRP's functions⁴⁵. The gateways were extended by statutory instrument in late 2006.⁴⁶

2.28 There are strong working links between the FSA and the FRRP. The two bodies agreed a Memorandum of Understanding in July 2005 which works well. They collaborate on the Committee of European Securities Regulators and are both members of the Committee's European Enforcers Co-ordination Session. In addition the FSA and the ASB liaised closely over International Accounting Standards on accounting for financial instruments. Finally, the FSA collects the FRC's levy on listed companies at the same time as it collects its own fees, thereby reducing the costs of collection and the administrative burden on authorised firms.⁴⁷

2.29 There are a number of issues on which the FSA and the FRC continue to liaise:

- Each year the Financial Reporting Review Panel prioritises sectors that will form the focus of its monitoring activity, based on a risk based assessment. The FSA provides the Panel with advice on developments in financial markets and they have adopted a risk-based approach which is similar (at a high level) to the FSA's methodology.
- There are currently only four firms auditing the majority of listed companies. The concentration in the market represents an issue for the FSA (who seek to maintain confidence in financial markets) and for the FRC (who focus on ensuring audit quality). The FSA and the FRC discuss developments in the audit market regularly.
- Both bodies have an interest in the development of the FSA's Listing Rules. They liaise closely, though the FRC noted that the FSA has at times made changes to the Listing Rules without consulting the FRC.

2.30 On likely future issues, institutional changes are underway at the European level. A new committee – the European Group of Audit Oversight Bodies (EAOB) – was established in early 2006 on which the FRC represents the UK, and the Company Law Directive comes into effect in 2008. The creation of this new committee will necessitate the continued close co-operation by the FSA and the FRC.

2.31 The FRC adopts a principles-based approach, for example in its Combined Code on corporate governance. This leaves companies scope for judgement on how to apply the requirements of the Code, including a “comply or explain” provision to allow for argued exemptions. As the FSA itself moves towards a more principles-based approach, it can learn from and share its experience with the FRC.⁴⁸

Joint working with other bodies

2.32 The FSA also liaises with other bodies in the UK:⁴⁹

- The **Financial Ombudsman Service (FOS)**⁵⁰ is operationally independent of the FSA, although the FSA is responsible for the overall regulatory framework.⁵¹ The Financial Services Practitioner Panel report in November 2006 indicates that practitioners they surveyed who had had dealings with the FOS, perceive there is still some disconnect between the FOS and the FSA, in particular that the FOS is assuming a policy setting role that is the responsibility of the FSA. The FOS provides regular updates to the FSA on the main issues it confronts and the FSA and the FOS have dedicated teams to liaise with one another, and a published process for dealing with wider implications cases.⁵² The relationship between the FSA and the FOS goes beyond the terms of reference of this review, and maybe affected by the statutory framework between the two bodies.
- The **Financial Services Compensation Scheme (FSCS)**⁵³ is operationally independent of the FSA, although the FSA is responsible for the overall regulatory framework.⁵⁴ The FSCS provides regular updates to the FSA on the main issues it confronts and the FSA and the FSCS have dedicated teams to liaise with one another.

- The FSA, **HM Treasury** and the **Bank of England** share responsibility for maintaining the UK's financial stability, through the "Tri-partite" arrangements. The roles and the division of responsibilities between the three authorities are spelt out in a published Memorandum of Understanding which was updated in 2006. Under these arrangements the authorities explore risks to financial stability and the resilience of the UK financial system to withstand shocks. Their resilience project, which examined the resilience of the system to operational disruption, is the most comprehensive study of financial sector resilience and recovery arrangements ever undertaken, and includes consideration of a wide range of risks, including terrorist attack and the consequences of a natural disaster. They have also conducted periodic tests to develop their ability to manage a potential financial crisis.
- The **Banking Code Standards Board** is a body with independent governance, and its role is to monitor compliance with and enforce the Banking Codes and to ensure subscribers provide a fair deal to their personal and small business customers. The Banking Code is sponsored by the British Bankers' Association, the Building Societies Association and APACS, the UK payments association. The Business Banking Code is sponsored by the British Bankers' Association and APACS. The codes cover current accounts (including basic bank accounts), personal loans and overdrafts, savings and deposit accounts (including cash ISAs and cash deposit Child Trust Funds), payment services, cards and PINs. The FSA has not generally imposed detailed conduct of business regulation on the deposit-taking business of subscribers to the Banking Codes, except where required by European law. The Banking Codes are therefore the main source of conduct of business standards for Codes subscribers. The Banking Codes are currently subject to an independently led triennial review. The FSA and the OFT worked collaboratively on their formal responses to the Banking Codes Review.